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OCTOBER TERM, 1980

No. 79-700

WALTER FLEISHER COMPANY, INC., a corporation, *Petitioner,*

vs.

COUNTY OF LOS ANGELES, et. al., *Respondents.*

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District

BRIEF FOR COMMITTEE ON UNITARY TAX AS AMICUS CURIAE

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BRIEF FOR COMMITTEE ON UNITARY TAX AS AMICUS CURIAE

INTEREST OF AMICUS

The Committee on Unitary Tax hereby respectfully files this Amicus Curiae Brief in support of Petitioner Walter Fleisher Company, Inc. The consents of the attorneys for Petitioner and for Respondent are attached hereto as Appendices "A" and "B".

Amicus Curiae is a California nonprofit corporation comprised of members concerned with the state taxation of international business. Members include corporations organized under the laws of various states of the United States, corporations organized under the laws of other nations, and individuals.

Amicus Curiae has devoted its principal attention to support of A.B. 525, a bill pending in the California Legislature, which would prohibit the application of combined reporting to foreign operations of foreign based taxpayers. A copy of this proposed legislation, as amended in the California Senate on May 22, 1980, is attached as Appendix "C." The California Franchise Tax Board, in administering the California Bank and Corporation Franchise (income) Tax, purports to tax only income derived in California by a corporation doing business in this state. In the case of a United States branch or subsidiary of a foreign (non-U.S.) corporation engaged in business in California, the Franchise Tax Board includes the foreign income of the foreign parent corporation (and of other foreign subsidiaries of the foreign parent) in income subject to apportionment in California when both the domestic and foreign business activities are deemed to constitute a unitary operation. Such inclusion has created grave administrative problems as well as distortions resulting from the combination of income determined under methods of accounting not used in the United States with income determined under California tax accounting rules. Further distortion results from the effects on earnings and apportionment data of changes in the foreign exchange rates. Extensive testimony has been presented which indicates that burdens of this apportionment method fall more heavily on foreign taxpayers than on domestic taxpayers.

Amicus Curiae is vitally interested in the impact of this litigation on international trade. Amicus Curiae is particularly concerned about this case and the earlier case of *Zee Toys, Inc. v. County of Los Angeles*, 85 Cal.App.3d 763, 149 Cal.Rptr. 750 (1978), cert. granted *sub nom. Sears, Roebuck & Co. v. County of Los Angeles*, October Term,

1978, 78-1577, because staff of the California Franchise Tax Board testified in hearings before the Assembly Revenue and Taxation Committee on November 13, 1979, that A.B. 525 is probably unconstitutional on the basis of *Zee Toys, Inc. v. County of Los Angeles.*[1]

ARGUMENT

The California Court of Appeal held California Revenue and Taxation Code Section 225 unconstitutional as a prohibited discrimination under the Commerce Clause (Art. I, section 8, clause 3). Section 225 exempted from the California property tax, a general *ad valorem* property tax, certain personal property manufactured (i) outside the state and brought into the state for transshipment out of the United States, or (ii) outside the United States and brought into the state for transshipment out of the state, for sale in the ordinary course of business. The court concluded that the exemption, granted only to transshipped goods originating in or destined for foreign commerce, was an unconstitutional discrimination against transshipped goods originating in and destined for interstate commerce, and any such discrimination was a direct interference with

1. Mr. Benjamin Miller, Counsel for the Franchise Tax Board, stated:

> "The California Appellate Court invalidated a state statute which exempted certain products shipped in foreign commerce from property taxation. The court held that the statute unconstitutionally discriminated in favor of foreign commerce, vis-a-vis interstate commerce. The court's reasoning might invalidate any efforts by the Legislature to place limitations on the application of the unitary concept based upon the geographic location of the operations."
>
> . . .
>
> "Based upon the court's holding [in Zee Toys], any attempt to limit the application of the unitary method, with respect to foreign-based businesses, would probably be constitutionally invalid."

the power of Congress to regulate both foreign and interstate commerce. The court based its decision on an earlier holding of the California Court of Appeal in *Zee Toys, Inc. v. County of Los Angeles*, 85 Cal.App.3d 763 (1978), presently on appear to this Court *sub nom. Sears, Roebuck and Co. v. County of Los Angeles*, October Term 1978, 78-1577 (hereafter referred to as the "companion case") and cited with approval that court's conclusion that a showing of burden upon commerce was not necessary.

This *per se* approach is inconsistent with this Court's recent holding in *Japan Line, Ltd. v. County of Los Angeles*, ... U.S. ....., 60 L.Ed. 2d 336 (1979), and the decisions of this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), *Washington Revenue Dept. v. Stevedoring Assn.*, 435 U.S. 734 (1978), and *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

A. The California Court Uses an Improper Analysis of the Commerce Clause.

This Court in its recent line of decisions interpreting the Commerce Clause has rejected ". . . a focus on . . . formalism [that] merely obscures the question whether the tax produces a forbidden effect." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. at p. 288.

The reasoning of the California court in this case and the companion case appears to be a return to that rejected formalism. If the California court means by its analysis that any exemption granted in the area of foreign commerce and not in interstate commerce is *per se* discriminatory or that any differing treatment between interstate and foreign commerce is an impermissible regulation of commerce in violation of the exclusive power of Congress to regulate, Amicus fears that a court cannot reach the paramount

inquiry—the practical effect of legislation on commerce. *Mobil Oil Corp. v. Commissioner of Taxes*, ... U.S. ....., 63 L.Ed.2d 510 (1980).

The California court never reaches the question of the "practical" effect of the tax. Part of the reason is that the California court treats the exemption as if it were the tax.[2] Since any exemption is, by its nature, intended to differentiate, any exemption when subjected to a "per se" analysis as if it were the tax is likely to be found discriminatory.[3] That is why this Court in the past has generally treated tax exemptions as classification questions under the Equal Protection Clause. See, *e.g.*, *Allied Stores of Ohio v. Bowers*, 358 U.S. 522 (1959).

The fallacy of the California court's reasoning is apparent when examined in the light of *Japan Line, Ltd. v. County of Los Angeles*. The California court would hold *per se* discriminatory an exemption from the California *ad valorem* property tax of foreign-owned instrumentalities of commerce in international trade since domestic-owned instrumentalities in interstate commerce did not receive a similar exemption. The practical effect of this Court's decision in *Japan Line, Ltd. v. County of Los Angeles* is to mandate such an exemption, yet the California court, under the reasoning of this case, could never uphold an exemption: it could never progress beyond the basic fact

2. The California court rejected the contention that there was any difference between a discriminatory tax and a discriminatory exemption. *Walter Fleisher Company, Inc. v. County of Los Angeles*, Appendix B, Petition for Writ of Certiorari, at pp. B-4—B-5.

3. It should be noted that the exemption does not discriminate against interstate commerce on its face. It simply exempts transshipped goods whose origin or destination is foreign. All other goods, including any others in transshipment (which by necessity would be those in interstate commerce), and all goods originating or coming to rest in California are subject to the tax.

of different, and hence discriminatory, treatment. The approach employed by the California court should not be allowed to stand since it precludes examination of the constitutional validity of exemptions.

The proper analysis of the exemption is an analysis of the tax with a consideration of the exemption's effect on the operation of the tax. This is not empty formalism since it places the burden of proof on the party claiming discrimination[4] and preserves the right of the state to set forth the balancing state policies and rebut the claim of discrimination. See *Hughes v. Oklahoma*, ... U.S. ....., 60 L.Ed.2d 250 (1979); *Lewis v. BT Investment Managers, Inc.*, ... U.S. ....., 48 U.S. L.W. 4638 (1980).

Even if there were no discrimination against interstate commerce, the California court would still hold that the exemption was an unconstitutional regulation of interstate and foreign commerce on the basis that differentiation between these areas is exclusively within the province of Congress. This Court now seldom applies the "zone of exclusivity" approach in its analysis of the Commerce Clause, particularly where the challenged regulation is a state tax. This Court's usual review is illustrated by such cases as *Moorman Mfg. Co. v. Bair*, 437 U.S. at pp. 278-280; *Mobil Oil Corp. v. Commissioner of Taxes*, 63 L.Ed.2d at p. 528.

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4. There is little or no evidence of any burden in the record. This is because the party allegedly aggrieved by the discriminatory exemption, a shipper which transships its goods in interstate commerce and on which any burden would rest, is not before the Court. Instead the party contending that the statute is unconstitutional is a subdivision of the state seeking to protect its tax base by an elimination of the exemption. This subdivision, the County of Los Angeles, opposes the decision made by the policy body of the state, the California Legislature, with respect to the shape and limits of the state's property tax. Because of this there has been no real exploration of the practical burden of the tax since there is no one before this Court who is concerned about burdens.

Moreover, this Court in *Japan Line, Ltd. v. County of Los Angeles* has eschewed such an analysis. Any state must now exempt such foreign-owned instrumentalities, not because any tax intrudes on some area of Federal exclusivity, but because the tax, *in operation*, jeopardizes the purposes of the Foreign Commerce Clause. Again, had that case come to the California court in the posture of an exemption of such foreign-owned instrumentalities from the California *ad valorem* property tax, the California court would have struck down the exemption as being an impermissible attempt to regulate between interstate and foreign commerce.

Michelin Tire Co. v. Wages, 423 U.S. 276 (1976) and *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977) do not support the approach of the California court.

The court relies on *Michelin* for the proposition that an exemption of foreign commerce constituted a regulation of such commerce. The court cited as authority this Court's discussion of why nondiscriminatory taxes are permissible:

> "It [a nondiscriminatory tax] cannot be used to create special protective tariffs or particular preferences for certain domestic goods, and it cannot be applied selectively *to encourage* or discourage any importation in a manner inconsistent with federal regulations." 423 U.S. at p. 286. (Emphasis added.)

Presumably the court reasoned that the exemption operated to encourage imports[5] and thus constituted an improper regulation even if it had no adverse effect on interstate or foreign commerce.

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5. It seems clear that the purpose of the California statute was not to encourage imports but rather to encourage importers to use California warehouses. Imports could come in to any of the other free port states including three surrounding California, namely Oregon, Nevada and Arizona, without paying property taxes. Imports would thus have no advantage in California which they would not have in the free port states.

As this Court pointed out in *Michelin*, the Framers of the Constitution committed the *sole* power to lay duties on imports to the federal government with no *concurrent* state power. 423 U.S. 276, 285. However, the Import-Export Clause differs from the Commerce Clause:

> "Although the parties dispute the meaning of the prohibition of 'Imposts or Duties on Imports or Exports,' they agree that it differs from the ban the Commerce Clause erects against burdens and taxation on interstate commerce. Brief for Petitioner, 32-33; Brief for Respondents, 9-10; T of Oral Arg 13-22. The Court has noted before that the Import-Export Clause states an absolute ban, whereas the Commerce Clause merely grants power to Congress."

Washington Revenue Dept. v. Stevedoring Assn., 435 U.S. at p. 751. See also Footnote 14, *Japan Line, Ltd. v. County of Los Angeles.*

The California court's reliance on *Boston Stock Exchange v. State Tax Commission* is equally misplaced. The California court cites this case as holding that discrimination between various types of interstate commerce is *per se* improper. It then analogizes this holding to discrimination between foreign and interstate commerce: both types of discrimination are unconstitutional and impermissible in the eyes of the California court because both fall *within areas* which only Congress may regulate. However, this Court in *Boston Stock Exchange v. State Tax Commission* was looking at the *purpose and effect* of the discrimination between two types of interstate commerce, namely ". . . to favor local commercial interests over out-of-state businesses. . . ." 429 U.S. at 335. The *Boston Stock Exchange* case is a classic Commerce Clause analysis of discrimination *in operation*. The California court's reading of this case

harks back to the old "zone of free trade" approach enunciated by such cases as *Freeman v. Hewit*, 329 U.S. 249 (1946) and overruled by this Court in *Complete Auto Transit, Inc. v. Brady*.

Finally the California court in the companion case rejects any showing of state interest or policy on the basis that this is not relevant under the Commerce Clause. Even in cases of discrimination on the face of the statute against interstate commerce, this Court has extensively explored state policies (see, *e.g., Lewis v. BT Investment Managers, Inc.*) in an effort to balance the competing interests of the state against the policies of the Commerce Clause.

Whatever the final outcome of this case, Amicus is particularly concerned that this Court reject the foregoing approach of the California court in reaching its conclusions. Amicus has stated the reasons for its concern in its statement of interest: pending legislation on the effect of the California Franchise (income) on foreign operations.[6]

Although this Court may have intimated in *Mobil Oil Corp. v. Commissioner of Taxes* that its analysis of property taxes in *Japan Line, Ltd. v. County of Los Angeles* might have no immediate application to an income tax, this Court has been consistent in its overall approach to Commerce Clause analysis: *Complete Auto Transit, Inc. v. Brady* (privilege tax); *Washington Revenue Dept. v. Stevedoring*

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6. The analysis used by the California court is being cited by staff of the Franchise Tax Board as precluding any showing that the legislation in which Amicus is interested is constitutionally permissible. (see reference at p. .... of this brief) Amicus does not believe that this is even a proper interpretation of the holding of the California court, but Amicus wishes to preclude any such arguments which would block a full review of the validity of any exemption in a proper case. A restoration of neutrality to a taxing system has been considered a proper objective. *Boston Stock Exchange v. State Tax Commission.*

Assn. (occupation tax); *Moorman Mfg. Co. v. Bair* (income tax); *Japan Line, Ltd. v. County of Los Angeles* (property tax). Accordingly, Amicus would urge this Court in any analysis to require a consideration of the practical effect of any tax (or any tax operating with an exemption) and to reject any *per se* approach which requires no showing of impermissible burden and no opportunity to balance competing interests, whether of the state or of national or international policy.

B. Federal Tariff Legislation Does Not Preempt the Statute.

Federal legislation will, of course, preempt state activity if such activity is not consonant with such legislation. The California court erroneously concluded that the exemption was an interference with the tariff laws of the United States. However, imports shipped through free port states have the same competitive advantage, which the California court saw stemming from this exemption, over goods originating in other states which are shipped through a state which taxes all goods equally. Thus, if there is interference, it derives from the lack of uniformity among the states with respect to their taxing policies. True preemption would seem to permit no taxation or require taxation only at uniform rates. However, this Court has been loath to find a necessity for uniformity in state taxing systems or any preemption, absent a clear direction from Congress. *Moorman Mfg. Co. v. Bair; Mobil Oil Corp. v. Commissioner of Taxes.*

C. Section 225 Does Not Create Discrimination Prohibited by the Commerce Clause.

In measuring a statute against the strictures of the Commerce Clause, this Court now looks to the practical effect of the statute to determine whether it is "applied to an

activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. at p. 279.

1. THE STATUTE DOES NOT DISCRIMINATE ON ITS FACE AGAINST INTERSTATE COMMERCE.

The initial question for this Court is whether the statute in question discriminates against or burdens interstate commerce. Although the test is often phrased in the alternative, Amicus knows of no case where impermissible discrimination does not create a burden. The statute which creates the impermissible burden must be the taxing statute since an exemption cannot create a burden. The California ad valorem property tax is nondiscriminatory. *Japan Line, Ltd. v. County of Los Angeles.*

The exemption itself does not make a distinction on the basis of residency or nonresidency. The exemption applies to certain goods in transshipment. There is another exemption, not before this Court, which applies to goods in transit, presumably those goods within the constitutional immunity accorded to foreign and interstate commerce. All other goods in the state at the lien date are not exempt. Goods which originate in or come to rest in the state no matter what their origins are subject to the tax so there is no favoring of local business. Accordingly, the combination of the tax and exemption does not discriminate against interstate commerce on its face.

Nor is the purpose of the exemption an improper purpose under the Commerce Clause. All parties seem to agree that the purpose of this statute was to preserve the local warehousing business, and the statute does not seek to preserve this business by discriminating against out-of-state ware-

housing businesses. Economic purposes or competitive purposes are not *per se* suspect. *Boston Stock Exchange v. State Tax Commission.*

2. NEITHER THE EXEMPTION NOR THE TAX INCLUDING THE EXEMPTION IMPERMISSIBLY BURDENS INTERSTATE COMMERCE.

A statute may be discriminatory in operation even if it is not discriminatory on its face.

Ordinarily, the party claiming discrimination has the burden of proof to show the existence of such discrimination. *Hughes v. Oklahoma.* Discrimination is not shown merely by different treatment, but rather is indicated by a burden created by the statute in question on interstate commerce. The burden must not be incidental. *Boston Stock Exchange v. Tax Commission; Raymond Motor Transportation, Inc. v. Rice*, 434 U.S. 429 (1978). The type of evidence which this Court should have available to it is best illustrated by *Raymond Motor Transportation, Inc. v. Rice* in which the petitioners demonstrated both economic burdens and the absence of safety implications in the regulations adopted by the State of Wisconsin with respect to the length of trucks passing through the state. Because the California court believed there was no necessity to show a burden on interstate commerce, the record is substantially devoid of any evidence on this point.

Evidence of an impermissible burden can also arise if the tax changes otherwise neutral economic behavior. This Court in *Boston Stock Exchange* found that because of other localizing tax incidents the seller could not escape tax liability by selling out of state but could reduce his liability by selling in state. Hence the decision of where to sell became weighted in favor of selling in New York. Under the California statute, a shipper can easily escape the California tax by not shipping through California. There is no

additional localizing incident as existed in the *Boston Stock Exchange* case which would foreclose this decision. Because of the history of this exemption, which was an attempt to preserve practices which existed until the decisions of the California court in *Volkswagen Pacific Inc. v. City of Los Angeles*, 7 Cal.3d 48 (1972) and this Court in *Michelin Tire Co. v. Wages*, shippers in interstate commerce did not face a situation substantially different after the enactment of the exemption than they had before. Economic decisions to take into account the burden of the tax had been made many years before so that the pattern of commerce in California was not disrupted or changed by this exemption. In short, there was no change of direction of commerce as occurred in *Boston Stock Exchange v. State Tax Commission*.

Finally, the tax continues to fall on local businesses. Accordingly, the usual presumption of validity should be afforded the state because the state's political processes remain as a check upon unwarranted burdens. *Raymond Motor Transportation, Inc. v. Rice*, 434 U.S., Footnote 18 at p. 444.

3. THE STATE HAS LEGITIMATE POLICY INTERESTS WHICH BALANCE ANY COMPETING POLICIES.

Because of the posture of this case before the Court, namely that neither the person burdened nor the state which determined taxing policies is a party hereto, and because the California court analyzed only the exemption and not the tax, there has been no full development of the state policies vindicating the taxing policy. The state has a right to require various forms of commerce to pay their fair shares, and it is ordinarily within the province of the state to determine the nature of that fair share so long as determination is not arbitrary.

Similarly, the state has a legitimate interest in encouraging commerce and in placing different forms of commerce on an equal footing by taxes, exemptions, and other forms of regulation. See *Boston Stock Exchange v. State Tax Commission.*

Not every tax is an impermissible burden on commerce, and not every tax has an anticompetitive effect. *Washington Revenue Dept.; Michelin Tire Co. v. Wages.* All taxing systems and other state regulations contain a network of deductions, distinctions and exemptions with the understanding that these may fall more heavily on some than on others. *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978). The granting of an exemption is a far cry from the extensive burden on interstate commerce feared by the Framers of the Constitution. As this Court has said in determining that a bounty granted on certain abandoned vehicles was a burden on interstate commerce simply because it was limited to vehicles registered in the state: "... the Commerce Clause (is) primarily intended (at least when Congress has not spoken) to inhibit the several States power to create restrictions on the free flow of goods within the national market, rather than provide the basis for questioning a State's right to experiment with different incentives to business." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 817 (1976) (concurring opinion.)

Indeed, this Court is loath to set aside state regulation unless a severe impediment to the Commerce Clause exists. In *Exxon Corp. v. Governor of Maryland*, it was stated: "This Court has only rarely held that the Commerce Clause itself pre-empts an entire field of state regulation, and then only when a lack of national uniformity would impede the flow of interstate goods." 437 U.S. 117 at p. 128.

Where the purpose of the tax is not suspect, where

the burden is simply a tax that was paid in the past and continues to be paid vis-a-vis goods on which the tax was not paid in the past, and where the record is devoid of any other anticompetitive effects or forbidden purposes, the California property tax operating with this exemption does not create a prohibited discrimination against interstate commerce.

CONCLUSION

The California court in its decision restored the meaningless formalism rejected by this Court in *Complete Auto Transit, Inc. v. Brady*. By so doing, it has eliminated any burden of proof on the party contending that the statute discriminates and also eliminated the opportunity for the Court to balance the competing constitutional policies and the state's interests. This Court has identified differing policies animating the Commerce Clause, Foreign Commerce Clause, and the Import-Export Clause, but the approach of the California court would foreclose any consideration of such policies which may not only permit, but require, differing treatment among the different forms of commerce. Amicus urges this Court to overrule the California court.

Respectfully submitted,

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Appendix A

[Letterhead]
May 20, 1980

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San Francisco, California 94111

Re: Walter Fleisher Company, Petitioner vs. County of Los Angeles, Respondent No. 79-700

Dear Ms. Garvey:

This will confirm that we have no objection and consent to your filing an Amicus Curiae Brief on behalf of Walter Fleisher Company.

Yours truly,

EVANS, MANPEARL & HARTER

By Gerald T. Manpearl

GTM/ns

Appendix B

COUNTY OF LOS ANGELES
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648 Hall of Administration
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May 21, 1980

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Ms. Joanne Garvey
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1 Maritime Plaza, Suite 1400
San Francisco, CA 94111

RE: Walter Fleisher Company, Petitioner v. County of Los Angeles, Respondent No. 79-700

Dear Ms. Garvey:

This will confirm our agreement with Gerald T. Manpearl to the effect that we have no objection and therefore consent to you filing an Amicus Curiae Brief on behalf of Walter Fleisher Company.

Very truly yours,
JOHN H. LARSON, County Counsel

By
Philip H. Hiekok
Deputy County Counsel

cc: Jerry Manpearl
PHH:jw

Appendix C

AMENDED IN SENATE MAY 22, 1980
AMENDED IN SENATE MAY 1, 1980
AMENDED IN SENATE MARCH 27, 1980
AMENDED IN ASSEMBLY JANUARY 28, 1980
AMENDED IN ASSEMBLY JANUARY 21, 1980
AMENDED IN ASSEMBLY SEPTEMBER 14, 1979
AMENDED IN ASSEMBLY MAY 16, 1979

CALIFORNIA LEGISLATURE—1979-80 REGULAR SESSION

ASSEMBLY BILL No. 525

Introduced by Assemblymen Hughes, Kapiloff, Imbrecht, Moore, Naylor, and Dennis Brown
(Principal coauthors: Assemblymen Mori and Deddeh)

February 12, 1979

REFERRED TO COMMITTEE ON REVENUE AND TAXATION

An act to add Section 25101.9 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 525, as amended, Hughes (Rev. & Tax.). Bank and Corporation Tax Law: unitary business.

Under the existing Bank and Corporation Tax Law, the income of a unitary business which is subject to taxation is determined by means of an apportionment formula based on income derived from or attributable to sources both within and without the state.

This bill would provide that in determining the income subject to tax of a bank, corporation, or other entity, there shall not be taken into account the income and apportionment factors of any other bank, corporation or other entity, if such bank, corporation, or other entity is (1) created or organized under the laws of a foreign country, and (2) not owned and controlled by a United States corporation or residents of the United States.

Corporations engaged in the steel business and a business owning agricultural land in this state are excepted from the provisions of the bill.

This bill would take effect immediately as a tax levy.

This bill would provide that if any provision of this act is held invalid, such invalidity shall not affect other provisions of the act which can be given effect without the invalid provision.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds that generally accepted accounting methods in general use by foreign based taxpayers are materially different from accounting methods used by United States based taxpayers, and income statements prepared under foreign accounting standards are not readily converted to income statements based on the California Bank and Corporation Tax Law. The Legislature further finds that many unresolved problems have arisen in accounting for changes in foreign exchange rates, both in determination of income and in constructing apportionment data of foreign based taxpayers, on a basis consistent with that used to determine income earned in California by United States taxpayers. The Legislature further finds that the cost burden of converting income statements of foreign based taxpayers to in-

come statements more comparable to those of United States based taxpayers is often substantially greater than any resulting tax on income considered to be earned in California. The Legislature further finds that the inclusion of foreign income in determining the tax liability of foreign economic interests wishing to invest in California has frequently resulted in unfair taxation of foreign based taxpayers and consequently acted as an impairment to investment and hindered the creation of new opportunities for employment and the diversification of the economic base of this state.

SEC. 2. Section 25101.9 is added to the Revenue and Taxation Code, to read:

25101.9. (a) Notwithstanding any other provision of this chapter (except as provided in subdivision (g)), in determining the income subject to tax of any bank, corporation, or other entity liable to report under this part, there shall not be taken into account the income or apportionment factors of any other bank, corporation, or other entity if such other bank, corporation, or other entity:

(1) Is created or organized under the laws of a foreign country; and

(2) Is not owned or controlled by a United States corporation or residents of the United States.

(b) *For purposes of this section, the activities conducted within or directed from the United States by any bank, corporation, or other entity meeting the conditions set forth under paragraphs (1) and (2) of subdivision (a) shall be deemed to be conducted by a separate bank, corporation, or other entity which does not meet such conditions, and, except as provided in subdivision (a), the income and apportionment factors of any such bank, corporation, or other entity shall be determined upon the basis of the books of account maintained by such bank or corporation or other entity with respect to the activities conducted within or directed from the United States and the income and*

apportionment factors with respect to such activities shall be taken into account in the manner authorized by this chapter.

(c) The Franchise Tax Board shall audit, at least once every four years, the separate accounting and arm's length transactions of any bank, corporation, or other entity determining income pursuant to this section.

(d) This section shall not apply in determining the income allocable to this state from a unitary business whose principal activity is the steel business, or a business owning agricultural land in this state. For the purpose of this subdivision, the term "steel business" means the manufacture or sale of products rolled, formed, shaped, drawn, extruded, forged, cast, fabricated, or otherwise similarly processed, or processed by a combination of two or more of such operations, from steel made by the open hearth, basic oxygen, electric furnace, Bessemer, or other steelmaking process. For purposes of this section, "agricultural land" is land used for the production of agricultural commodities for commercial purposes.

(e) For purposes of this section, direct or indirect ownership or control of more than 50 percent of the voting stock shall constitute ownership or control.

(f) The following definitions shall apply for the purposes of this section:

(1) The term "residents of the United States" means residents of the United States, its territories, or possessions, or the Commonwealth of Puerto Rico.

(2) The term "United States corporation" means a bank, corporation, or other entity organized under the laws of the United States, its political subdivisions, its territories, or possessions, or the Commonwealth of Puerto Rico.

(g) Nothing in this section shall preclude the Franchise Tax Board from distributing apportioning, or allocating gross income, deductions, credits, or allowances between or among organizations, trades, or businesses, if it determines that it is necessary to do so in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses.

(h) *In view of pending litigation concerning the question of whether a corporation liable to report under the Bank and Corporation Tax Law must take into account the income and apportionment factors of other corporations operating in a foreign country, it is not intended that any inference be drawn from the enactment of this act in any litigation concerning such question.*

SEC. 3. This act shall not be effective for income years beginning on or after January 1, 1980, if an initiative constitutional amendment to limit state income tax rates to one-half, which is on the June 1980, ballot, is approved by the voters.

SEC. 4. The Legislative Analyst shall report to the Legislature during the 1988 legislative session on the impact of this act.

SEC. 5. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect. However, the provisions of this act shall apply in the computation of taxes for income years beginning on or after January 1, 1980.

SEC. 6. *If any provision of this act or the application thereof to any person or circumstance is held invalid or unconstitutional because it favors foreign-based corporate entities over domestic-based corporate entities or for any other reason, then this act shall be invalid in its entirety and shall be repealed.*